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The Obligation of Regulatory Stability in the Fair and Equitable Treatment Standard: How Far Does it Go?

Dr Federico Ortino¹

I. Introduction

In the world of foreign investment, the risk of ‘adverse regulatory change’ in the host State is one of foreign investors’ top so-called ‘political risks’.² While there may be several techniques to address such political risk (including stabilization clauses³ or political risk insurance),⁴ foreign investors have recently relied on one of the key investment protection guarantees, the fair and equitable treatment (FET) standard,⁵ which is found in most modern international investment treaties, concluded since the 1960s by States in order to promote foreign investment.⁶ Investors’ have often put forward two key arguments in order to claim that the FET standard provides for a guarantee or obligation of regulatory stability. First, foreign investors have claimed that the obligation to provide ‘fair and equitable treatment’ entails “the obligation to maintain a stable legal framework for the investment”.⁷ Second, foreign investors have also argued that changes in the legal framework of the host State (including general laws and regulations) have “frustrated the investor’s legitimate expectations on the basis of which the investment was made and has thus breached the obligation to accord it fair and equitable treatment.”⁸

While it is undisputed that the obligations “to provide a stable legal framework” and “to protect investors’ legitimate expectations (of stability)” have been recognized as specific

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² *World Investment and Political Risk 2013* (Washington, DC: MIGA, World Bank Group), at 19-22 and 41 (“58 percent named adverse regulatory changes as the most important political risks they face in the next three years”).

³ Abdullah Faruque, ‘Validity and Efficacy of Stabilisation Clauses: Legal Protection vs. Functional Value’, 23 *Journal of International Arbitration* 317 (2006); Piero Bernardini, ‘The Renegotiation of the Investment Contract’ 13(1) *ICSID Review* 411 (1998); Thomas Wälde and George N’Di, ‘Stabilising International Investment Commitments’, 31 *Texas International Law Journal* 215 (1996); Nagla Nassar, *Sanctity of Contracts Revisited: A Study in the Theory and Practice of Long-Term International Commercial Transactions* (Martin Nijhoff, 1995).

⁴ Kathryn Gordon “Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development” *OECD Investment Policy Perspectives* (2008) available at <https://www.oecd.org/finance/insurance/44230805.pdf>.

⁵ While foreign investors often also face unilateral modification (or termination) of so called investment contracts (concluded between the investor and the host State), the present paper focuses on changes in general laws and regulations (or general regulatory framework).

⁶ In order to address adverse regulatory change, foreign investors have also relied on other provisions commonly found in international investment treaties, such as the provisions on expropriation. However, the focus of this paper is on the FET standard, only.

⁷ *Bayindir v Pakistan*, Decision on Jurisdiction, 14 November 2005, para. 239-40.

⁸ *Occidental v Ecuador I*, Award, 1 July 2004, para. 181.

applications of the FET standard,⁹ it is submitted here that the extent to which the FET standard disciplines ‘regulatory change’ in the absence of an express stabilization commitment from the host State is far from clear. The paper’s premise is that conceptually there exist at least two alternative understandings of the guarantee of regulatory stability as part of the FET provision. According to one view, the FET provision requires *strict* regulatory stability, thus the *existence* of a change in the regulatory framework applicable to the investment is sufficient to trigger a violation of the FET provision. According to a second view, the FET provision only imposes a *soft* regulatory stability obligation, where the violation analysis has to consider the *merit* (ie., the procedural fairness and substantive reasonableness) of the regulatory change under review.

Early decisions by investment tribunals interpreting the FET standard contain statements supporting either the “strict” or “soft” understanding of a stability obligation. One of the paradigmatic examples of a tribunal interpreting the FET provision as requiring strict regulatory stability is *Occidental v Ecuador I*. Having stated that “[t]he stability of the legal and business framework is [...] an essential element of fair and equitable treatment”,¹⁰ the *Occidental v Ecuador I* noted that a determination of whether there is a breach of the FET standard is premised on whether or not the host State has “alter[ed] the legal and business environment in which the investment has been made.”¹¹ On the other hand, the 2006 decision in *Saluka v Czech Republic* adopted a softer, more deferential, interpretation of regulatory stability as part of FET, focusing, at least in part, on the fairness/reasonableness of the regulation under review.¹² In the view of the *Saluka* tribunal, in order to be protected, the investor’s expectations “must rise to the level of legitimacy and reasonableness in light of the circumstances”¹³ and a determination of a breach of the FET standard “requires a weighing of the Claimant’s legitimate and reasonable expectations on the one hand and the Respondent’s legitimate regulatory interests on the other.”¹⁴

While more recent tribunals regularly acknowledge the host State’s inherent right to regulate in the public interest, it is suggested here that there is still a level of ambiguity with regard to the extent to which the FET standard disciplines regulatory change. Various recent disputes concerning, for example, the introduction of plain packaging legislation for cigarettes in Uruguay, jurisprudential changes in intellectual property protection in Canada and changes in

⁹ Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (Oxford: OUP 2012, second edition), at 145.

¹⁰ The *Occidental v Ecuador I* tribunal relied on the clear statement found in the preamble of the underlying treaty (the 1993 Ecuador-United States BIT) that FET “is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources”. *Occidental v Ecuador I*, Award, 1 July 2004, at para 183.

¹¹ *Occidental v Ecuador I*, Award, 1 July 2004, para. 191. See Rudolf Dolzer, ‘Fair and Equitable Treatment: Today’s Contours’, 12 *Santa Clara Journal of International Law* 7 (2013), at 22. See also Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (Oxford: OUP 2012, second edition), at 145.

¹² *Saluka v Czech Republic*, Partial Award, 17 March 2006.

¹³ *Saluka v Czech Republic*, *ibid.* para. 304.

¹⁴ *Saluka v Czech Republic*, *ibid.* para. 306.

solar energy subsidies in various EU countries have highlighted this fundamental ambiguity.

The persistent ambiguity with regard to the extent to which the FET standard disciplines ‘regulatory change’ feeds in to the current debate about whether the protections granted to foreign investors by investment treaties impose excessive restraints on host States’ ability to regulate in the public interest.¹⁵ In this debate, one should keep in mind the role of perceptions, particularly those of a wider (perhaps non-expert) audience including local legislators, regulators, and communities. The perception that investment treaties *may* be (or have at times been) interpreted to include an obligation of regulatory stability in the strict sense (detached from an analysis of the underlying public policy justifications) would be enough to create serious concerns. It is thus not surprising that the contracting parties of the 2016 EU-Canada Comprehensive Economic and Trade Agreement (CETA) felt the need to expressly clarify that a modification to laws, which negatively affects an investment or interferes with an investor's expectations, does not amount to a breach of any investment protection obligation.¹⁶

The aim of the paper is thus to shed light on the way investment treaty tribunals have imposed on host States a guarantee of regulatory stability under the FET provision (whether through the obligation to provide a stable legal framework or through the obligation to protect investors’ legitimate expectations of stability). The paper traces the origin and evolution of such regulatory stability guarantee as part of the FET provision in the practice of investment tribunals. The paper focuses, in particular, on assessing whether and, if so, the extent to which the FET standard has been interpreted by investment tribunals as an obligation of regulatory stability in the strict sense, that is whether a *change* in the host State’s regulations affecting the foreign investment is sufficient to establish a violation of the FET clause without the need to consider the reason(s) underlying such change.

The paper’s main argument is as follows: despite the fact that investment tribunals have increasingly recognized the need to find a better balance between protecting foreign investors from adverse regulatory changes and the right of host States to regulate in the public interest, one can find recent arbitral decisions where the role of regulatory stability within the FET standard remains at best ambiguous and which thus fail to assuage the fears that the FET standard may indeed function as imposing an obligation of regulatory stability in the strict sense.

¹⁵ See M Sornarajah, *The International Law on Foreign Investment* (Cambridge: CUP 2010, 3rd edition), at 355; Moshe Hirsch, ‘Between Fair and Equitable Treatment and Stabilization Clause: Stable Legal Environment and Regulatory Change in International Investment Law’, 12 *J. World Inv. & Trade* 783 (2011); Lise Johnson & Oleksandr Volkov, ‘Investor-State Contracts, Host-State “Commitments” and the Myth of Stability in International Law’, 24 *Am. Rev. Int’l Arb.* 361 (2013); Michele Potestà, ‘Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept’, 28 *ICSID Review* (2013), at 34; Christopher Campbell, ‘House of Cards: The Relevance of Legitimate Expectations under Fair and Equitable Treatment Provisions in Investment Treaty Law’, 30 *Journal of International Arbitration* (2013), at 379.

¹⁶ See Article 8.9, paragraph 2 of EU-Canada CETA.

This article is structured as follows: after this introduction, the second section briefly elaborates on the conceptual distinction between ‘strict’ and ‘soft’ stability obligations. The third section examines the origin of the obligation of stability, positing that a handful of early investment arbitral decisions do appear to have interpreted the FET provision to include the obligation of regulatory stability in the strict sense. The fourth section examines the subsequent arbitral practice, which seems to reverse the early decisions and rely instead on a soft understanding of regulatory stability obligation. The fifth section focuses on the most recent arbitral practice and shows how some investment tribunals still fail to clearly set out the role of regulatory stability within the FET standard.

II. The conceptual framework: ‘strict’ versus ‘soft’ stability obligation

As noted above, investors often put forward two separate grounds in order to claim a breach of the FET provision because of an adverse regulatory change: 1) the host State has violated the obligation to provide a stable regulatory framework and 2) the host State has violated the obligation to protect investors’ legitimate expectations (including the expectation that the regulatory framework would not change during the life of the investment).

There are at least two ways in which either ground above could be understood in principle. With regard to the argument based on the obligation to provide a stable regulatory framework, one can understand such obligation akin to a stabilization clause *stricto sensu*, which is at times agreed between the foreign investor and the host State in order to ‘freeze’ the law applicable to the investment at the time of the signature of the underlying contract.¹⁷ Reading the FET provision to include such a strict stability obligation would in practice mean that FET requires a host State to compensate the foreign investor in case of *a change* in the general regulatory framework detrimental to such investor (even if no specific stabilization commitment had been made to the investor by the host State). Alternatively, such stability obligation can be understood in a softer sense as one requiring that any regulatory change in the host State be ‘reasonable’ or ‘reasonably related to a legitimate public policy objective’. Under this alternative reading, compensation would be due under the treaty not because of a detrimental change in the regulatory framework, but because the measure introducing the change is judged unreasonable. While such reasonableness test may take different forms (including procedural fairness, substantive rationality, or proportionality tests),¹⁸ the distinctive feature of this alternative understanding is that the analysis will include an examination of the *merit* of the regulatory change.

¹⁷ “A stabilisation clause *stricto sensu* intends to ensure that the law applicable to the petroleum contract will not change over the life of the project. This is a more traditional approach which tries to impose an absolute block on the legislative competence of the host state.” Faruque, ‘Validity and Efficacy of Stabilisation Clauses’, above n 7, at 319.

¹⁸ See Valentina Vadi *Proportionality, Reasonableness and Standards of Review in International Investment Law and Arbitration* (Edward Elgar, 2018).

Similarly, with regard to the argument that the host State has violated the obligation to protect the investors' legitimate expectations, two alternative understandings exist in principle. On the one hand, one could argue that foreign investors can legitimately rely on the general expectation that the regulatory framework applicable at the time the investment is made will not be subsequently modified (at least in a substantial manner) by the host State to the detriment of the foreign investment. On the other hand, one could argue that investors' expectations would be worthy of protection under the FET provision only if they are (a) legitimate and reasonable under the specific circumstances and in any event (b) balanced vis-à-vis the host State's right to regulate in the public interest. In other words, under the latter view, a blanket expectation about no (at least substantial) changes in the applicable regulatory framework does not exist and the focus is instead on, again, the merit (or fairness/reasonableness) of the regulatory change.

The paper's premise is that these two sets of alternative understandings highlight two conceptually-distinct norms. According to one view, the FET provision requires strict regulatory stability, thus the mere existence of a change in the regulatory framework applicable to the investment is sufficient to trigger a violation of the FET provision. Under this view, the relevant question at issue would be whether the new law regulating, for example, the production and sale of a certain pharmaceutical product has modified (perhaps substantially) the regulatory regime applicable to the foreign investor.

According to the other view, the FET provision imposes a softer notion of regulatory stability by focusing on (or at least including in the analysis) the procedural fairness and substantive reasonableness of the regulatory change rather than on the mere existence of change. Under this view, the relevant question would be whether the new law on pharmaceutical products, for example, has been adopted in accordance with due process and is rationally justified on the basis of a legitimate public policy (see Table 1 below).

	Strict stability	Soft stability
Regulatory stability requirement	Existence of change	Lack of fairness and/or reasonableness/proportionality
Protection of investors' expectations (of stability)	Existence of change	Lack of fairness and/or reasonableness/proportionality

Table 1: Two distinct norms stemming from the FET provision

There are of course shades of each understanding. A strict stability obligation may be subject to the condition that the change in the regulatory framework be of a certain magnitude (excluding, for example, minor changes). Similarly, a soft stability obligation may be subject to various degrees of review, for example, along the lines of the various tests provided for by the proportionality principle (suitability, necessity, cost-benefit balancing).¹⁹

¹⁹ See Caroline Henckels, *Proportionality and Deference in Investor-State Arbitration: Balancing Investment Protection and Regulatory Autonomy* (Oxford: OUP 2016).

Nevertheless, it is clear that from the perspective of the foreign investor, a strict stability obligation would afford a very high level of protection vis-à-vis the risk of adverse regulatory change (as the investor will be compensated for the mere existence of such change). Conversely, a soft stability obligation would afford a greater degree of discretion to the host State as, at a minimum, the existence of an FET violation (and the duty to compensate the investor) would depend in relevant part on an assessment of the merits of the new regulation at issue.

III. Linking FET and regulatory stability: the early attempt

In the early 2000s (particularly between 2003-2006), at a time when investment treaty arbitration was still in its infancy, one can find a line of arbitral decisions that appear to put forward an interpretation of the FET provision, which includes the obligation of regulatory stability in the strict sense.²⁰ These tribunals relied principally on (i) the need to protect investors' expectations and/or (ii) statements in treaty preambles linking FET with 'stability'.²¹ For example, the tribunal in *Tecmed v Mexico* notoriously stated in a 2003 decision that the FET provision requires the contracting parties to provide to international investments "treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment", including the expectation that the host State acts "in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor".²²

In 2004, as noted above, the tribunal in *Occidental v Ecuador I* expressly stated that the stability of the legal and business framework is an essential element of fair and equitable treatment. The tribunal relied on the clear statement found in the preamble of the underlying treaty (the 1993 Ecuador-United States BIT) that FET "is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources".²³ One of the key questions at issue in *Occidental I* was whether the host State had breached the FET provision by modifying the ability of certain exporters to claim a VAT refund. The tribunal explained its finding in the following terms:

The relevant question for international law in this discussion is [...] whether the legal and business framework meets the requirements of stability and predictability under international law. It was earlier concluded that there is not a VAT refund obligation

²⁰ Potestà, above n ??, at 24.

²¹ Express references to 'stability' in investment treaties are rare. They are usually contained in the preamble (see for example some United States treaties) or in the protection guarantee (see in particular Article 10(1) of the Energy Charter Treaty). More infra.

²² *Tecmed v Mexico*, Award, 29 May 2003, para. 154. An even earlier tribunal in the context of finding a violation of fair and equitable treatment in the context of Article 1105 NAFTA, referred to the host State's failure "to ensure a transparent and predictable framework" as well as to the investor's "expectation that it would be treated fairly and justly". *Metalclad v Mexico*, Award, 30 August 2000, para. 99.

²³ *Occidental v Ecuador I*, Award, 1 July 2004, at para 183.

under international law, [...] but there is certainly *an obligation not to alter the legal and business environment in which the investment has been made*. In this case it is the latter question that triggers a treatment that is not fair and equitable. [emphasis added]²⁴

In 2005, the tribunal in *CMS v Argentina* similarly affirmed that “a stable legal and business environment is an essential element of fair and equitable treatment.”²⁵ The *CMS* tribunal also specifically relied for its interpretation of the FET provision on the preamble of the applicable investment treaty (the 1991 United States-Argentina BIT), where the contracting parties had expressed their agreement “that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective use of economic resources”.²⁶

A few other decisions in 2006-07, relying on these precedents, affirmed that the stability requirement is a key element of FET.²⁷ In *PSEG v Turkey*, for example, the Tribunal found that the host State conduct had seriously breached the FET obligation in light of “the ‘roller-coaster’ effect of the continuing legislative changes.”²⁸ In *Sempra v Argentina*, the tribunal captured the key issue as follows: “What counts is that in the end the stability of the law and the observance of legal obligations are assured, thereby safeguarding the very object and purpose of the protection sought by the treaty”.²⁹ The *Sempra* tribunal also discarded the relevance of any justifications for introducing such changes in the legal and business framework. Having found that the emergency legislation implemented by Argentina had, beyond any doubt, substantially changed the legal and business framework under which the investment was decided and implemented, the *Sempra* tribunal concluded that there had been an “objective breach” of the FET provision “even assuming that the Respondent was guided

²⁴ *Occidental v Ecuador I*, Award, 1 July 2004, at para 191.

²⁵ *CMS v Argentina*, Award, 12 May 2005, para. 274. Very similar approach and language is found in *LG&E v Argentina*, Decision on Liability, 3 October 2006, paras 124 and 131 (“Tribunal must conclude that stability of the legal and business framework is an essential element of fair and equitable treatment in this case”), *Enron v Argentina*, Award, 22 May 2007, paras 259-60 (“the Tribunal concludes that a key element of fair and equitable treatment is the requirement of a ‘stable framework for the investment’, which has been prescribed by a number of decisions”) and *Sempra v Argentina*, Award, 28 September 2007, para. 300 (“What counts is that in the end the stability of the law and the observance of legal obligations are assured, thereby safeguarding the very object and purpose of the protection sought by the treaty”).

²⁶ *CMS v Argentina*, Award, 12 May 2005, para. 274. This is true also for the *LG&E* and *Enron* decisions.

²⁷ *Enron v Argentina*, Award, 22 May 2007, paras 259-60 (“the Tribunal concludes that a key element of fair and equitable treatment is the requirement of a ‘stable framework for the investment’, which has been prescribed by a number of decisions”). Very similar language can be found in *LG&E v Argentina*, Decision on Liability, 3 October 2006, paras 124 and 131 (“Tribunal must conclude that stability of the legal and business framework is an essential element of fair and equitable treatment in this case”).

²⁸ *PSEG v Turkey*, Award, 19 January 2007, para. 250.

²⁹ *Sempra v Argentina*, Award, 28 September 2007, para. 300.

by the best intentions”.³⁰

The distinguishing key feature of these various decisions is the fact that the tribunals assessed the existence of an alleged breach of the FET provision due to a change in the general regulatory framework of the host State without any reference to, or examination of, the reasons or justifications for such change. In other words, these tribunals’ assessment focused on the existence of a change. However, while these early decisions do appear to make reference to a strict notion of regulatory stability imposed by the FET standard, a closer analysis raises some doubts about the nature of the regulatory stability obligation actually imposed by these tribunals.

First of all, while the *Tecmed* decision appears to represent one of the first leading precedents underlying these early decisions establishing a stability obligation, that decision never expressly mentions the concept of ‘stability’ or ‘stable legal framework’. As part of the host State obligation to provide treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment, the *Tecmed* tribunal focused instead on the expectation of ‘consistency’ and ‘transparency’.³¹ Furthermore, the *Tecmed* tribunal defines a ‘consistent act’ as one “without arbitrarily revoking any pre-existing decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities.”³² While one may still criticise the *Tecmed*’s consistency standard as being excessive or aspirational,³³ it is not altogether clear whether the *Tecmed* tribunal read FET as imposing an obligation of regulatory stability in the strict sense.

Second, in the reasoning of these early tribunals, the relationship between the investor’s distinct arguments regarding stability requirement and the investor’s expectations (of stability) remains unclear. On the one hand, some tribunals appear to treat the two together by including predictability, consistency or stability as some of the investor’s expectations that should be protected by the FET provision.³⁴ On the other hand, at least one tribunal seemed to distinguish the two components of FET (‘regulatory stability’ and ‘protection of the investor’s expectations’).³⁵

Third, some of these early tribunals were not clear whether a change in the regulatory

³⁰ *Sempra v Argentina*, Award, 28 September 2007, para. 303-04. See also *Enron*, Award, 22 May 2007, para. 268.

³¹ *Tecmed v Mexico*, at 154.

³² *Tecmed v Mexico*, at 154.

³³ Zac Douglas, ‘Nothing if Not Critical for Investment Treaty Arbitration: *Occidental*, *Eureko* and *Methanex*’, 22 *Arbitration International* 27 (2006), at 28.

³⁴ See *Tecmed v Mexico*, Award, 29 May 2003, para. 154.

³⁵ *LG&E v Argentina*, Decision on Liability, 3 October 2006, para. 127. To note also that, despite the reference to the relatively well-known legal concept of ‘legitimate expectations’ in the arguments of the disputing parties, these early tribunals refrained from expressly referring to such concept and instead limited their references to a broader notion of investors’ ‘expectations’. See for example *Occidental v Ecuador I*, para. 181.

framework violated the FET standard only in the presence of a specific stabilization commitment made by the host State. For example, having determined that the emergency legislation under review “did in fact entirely transform and alter the legal and business environment under which the investment was decided and made”,³⁶ the *CMS v Argentina* tribunal stated as follows: “It is not a question of whether the legal framework might need to be frozen as it can always evolve and be adapted to changing circumstances, but neither is it a question of whether the framework can be dispensed with altogether *when specific commitments to the contrary have been made*.”³⁷ The highlighted sentence is particularly important in terms of understanding what kind of obligation the *CMS* tribunal read in to the FET provision. On the one hand, reading the FET provision as imposing an obligation of stability in the strict sense would mean that a violation would occur simply if the host State introduces an adverse (and possibly substantial) change in the regulatory framework applicable to the investment. On the other hand, limiting a finding of violation of the FET provision when the host State has modified the regulatory framework *in the presence of* a stabilization commitment (as hinted by the *CMS* tribunal in the above quoted sentence) greatly narrows the scope of the stability obligation under FET: in the latter sense, one could argue that the FET provision merely guarantees the stabilization commitment already undertaken by the host State, but it does not represent a stabilization commitment in itself.

Aside from the lack of clarity and elaboration with regard to the extent to which the FET standard provides for a guarantee vis-à-vis regulatory change, it is nevertheless submitted that there was enough in these early decisions to justify the argument (or fear) that the FET provision could actually embody an obligation of regulatory stability in the strict sense akin to a contractual freezing clause. In a study published in 2012, UNCTAD concluded that some investment tribunals “have gone so far as to suggest that any adverse change in the business or legal framework of the host country may give rise to a breach of the FET standard in that the investors’ legitimate expectations of predictability and stability are thereby undermined.”³⁸

IV. Subsequent arbitral practice rejects the link between FET and strict regulatory stability: the refinement of the doctrine of investor’s legitimate expectations

The handful of decisions that, in the infancy of investment treaty arbitration, appeared to read the FET provision to include an obligation of regulatory stability in the strict sense remain limited in number³⁹ and have been overtaken by a subsequent, large arbitral practice denying the existence of such strict stability obligation as part of the FET provision.

³⁶ *CMS v Argentina*, Award, 12 May 2005, para. 275.

³⁷ *CMS v Argentina*, Award, 12 May 2005, para. 277 [emphasis added].

³⁸ UNCTAD *Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements II* (Geneva, United Nations, 2012) at 67.

³⁹ In one sense, this group of decisions was possibly also limited in authorship as most of them were rendered by tribunals chaired by Professor Orrego Vicuna (*Occidental*, *CMS*, *Enron* and *Sempra*).

The initial blow to a broad interpretation of the FET provision hinged on the rejection of the view that the FET provision protects the investor's general expectation of regulatory stability. In 2006, as noted above, the tribunal in *Saluka v Czech Republic* was one of the first investment tribunals to reject reading the FET provision as imposing an obligation of regulatory stability in the strict sense.⁴⁰ In the view of the *Saluka* tribunal, an interpretation of the FET provision requiring the protection of a too large set of investor's expectations (including the expectation of legal stability) would be "inappropriate and unrealistic". In the view of the *Saluka* tribunal, in order to be protected, the investor's expectations "must rise to the level of legitimacy and reasonableness in light of the circumstances".⁴¹ Noting that no investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged, the *Saluka* tribunal specified that "the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well."⁴²

In 2007, the *ad hoc* Committee in *MTD v Chile* referred to the *Tecmed* tribunal's apparent reliance on the foreign investor's unqualified expectations as the source of the host State's obligations as "questionable".⁴³ In other words, investors' expectations *sic et simpliciter* cannot create legal obligations (including strict stability obligations).

Furthermore, in 2008, the tribunal in *Continental v Argentina* was the first to oppose reading too much in the link between FET and stability referred to in the preamble of some investment treaties (such as the United States-Argentina BIT). The *Continental* tribunal noted that such reference in the preamble does not constitute a legal obligation in itself, nor can it be properly defined as an object of the treaty. In the view of the tribunal, while stability of the legal framework is undoubtedly conducive to attracting foreign investments, "it would be unconscionable for a country to promise not to change its legislation as time and needs change, or even more to tie its hands by such a kind of stipulation in case a crisis of any type or origin arose."⁴⁴

There are plenty of statements in subsequent arbitral decisions (a) rejecting a broad interpretation of the FET provision that includes a strict regulatory stability obligation and (b) affirming instead the host State's prerogative to modify its laws and regulations as part of its inherent right to regulate.⁴⁵ For example, in the context of determining a claim based on the

⁴⁰ *Saluka v Czech Republic*, Partial Award, 17 March 2006, para. 302.

⁴¹ *Saluka v Czech Republic*, *ibid.* para. 304.

⁴² *Saluka v Czech Republic*, *ibid.* para. 305.

⁴³ *MTD v Chile*, Decision on Annulment, 21 March 2007, at 67.

⁴⁴ *Continental v Argentina*, Award, 5 September 2008, para. 258 ("Such an implication as to stability in the BIT's Preamble would be contrary to an effective interpretation of the Treaty; reliance on such an implication by a foreign investor would be misplaced and, indeed, unreasonable.")

⁴⁵ Several scholars agree: Moshe Hirsch, 'Between Fair and Equitable Treatment and Stabilization Clause: Stable Legal Environment and Regulatory Change in International Investment Law', 12 *Journal of World Investment and Trade* (2011) at 806 ("In the absence of stabilization clauses, investment tribunals are not inclined to interpret FET clauses as effectively equivalent to stabilization

FET provision, the tribunal in *Parkerings v Lithuania* stated that: “It is each State’s undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion.”⁴⁶ In a similar vein, the tribunal in *EDF v Romania* stated that the investor “may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State’s legal and economic framework.”⁴⁷ Similarly, the tribunal in *Total v Argentina* stated that the parties to an investment treaty “do not thereby relinquish their regulatory powers nor limit their responsibility to amend their legislation in order to adapt it to change and the emerging needs and requests of their people in the normal exercise of their prerogatives and duties. Such limitations upon a government should not lightly be read into a treaty which does not spell them out clearly nor should they be presumed.”⁴⁸ The *El Paso v Argentina* tribunal most clearly rejected an interpretation of the FET provision that includes an obligation of regulatory stability in the strict sense noting the following:

[T]he Tribunal cannot follow the line of cases in which fair and equitable treatment was viewed as implying the stability of the legal and business framework. Economic and legal life is by nature evolutionary. [...]

[I]t is inconceivable that any State would accept that, because it has entered into BITs, it can no longer modify pieces of legislation which might have a negative impact on foreign investors, in order to deal with modified economic conditions and must guarantee absolute legal stability. In the Tribunal’s understanding, FET cannot be designed to ensure the immutability of the legal order, the economic world and the social universe and play the role assumed by stabilisation clauses specifically granted to foreign investors with whom the State has signed investment agreements.⁴⁹

The bulk of the arbitral practice (following from the *Saluka* decision) shows that the starting point of the analysis with regard to the investor’s *claim* of regulatory stability under the FET provision was the doctrine of ‘legitimate expectations’ rather than a broad legal stability obligation (possibly linked to investors’ expectations).⁵⁰ Moreover, such arbitral practice has

clauses, and regulatory changes alone are insufficient in binding the host states to compensate foreign investors harmed by such changes”); Ursula Kriebaum, ‘FET and Expropriation in the (Invisible) EU Model BIT’, 15 *Journal of World Investment and Trade* (2014) at 471 (“In recent years, tribunals have moved towards a more reserved approach concerning the stability limb of fair and equitable treatment and have moved to a more cautious approach concerning the FET standard and the right to regulate. In other words, they have stressed the need for States to maintain a regulatory space”); Joshua Paine, ‘On Investment Law and Questions of Change’, 19 *Journal of World Investment and Trade* 173 (2018).

⁴⁶ *Parkerings v Lithuania*, Award, 11 September 2007, para. 332.

⁴⁷ *EDF v Romania*, Award, 8 October 2009, para. 217.

⁴⁸ *Total v Argentina*, Decision on Liability, 27 December 2010, para. 115.

⁴⁹ *El Paso v Argentina*, Award, 31 October 2011, paras. 352 and 367-68. See further Hirsch, above, at 793-799.

⁵⁰ See Potesta, above; Caroline Henckels, *Proportionality and Deference in Investor-State Arbitration: Balancing Investment Protection and Regulatory Autonomy* (Cambridge, CUP 2015) at 74; Simon Maynard, ‘Legitimate Expectations and the Interpretation of the ‘Legal Stability Obligation’’, 1 *European Investment Law and Arbitration Review* (2016) at 109-111; McLachlan,

interpreted the obligation to protect investors' legitimate expectations to exclude a guarantee of stability in the strict sense by referring to three specific factors.

The first factor referred to by investment tribunals in order to determine the legitimacy of the investor's expectation (of regulatory stability) is the existence of a specific promise or representation of stability given by the host State and relied upon by the investor. For example, according to the tribunal in *EDF v Romania*, "[e]xcept where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable."⁵¹ Accordingly, the investor's expectation that the general regulatory framework at the time in which the investment is made will not be subject to change (detrimental to its investment) does *not* deserve treaty protection under the FET provision *at least unless* specific promises or representations of regulatory stability have been made by the host State.⁵²

A second factor often referred to by investment tribunals in evaluating the legitimacy of investors' expectations worthy of protection under FET is whether the adverse regulatory change under review is in itself reasonable or reasonably related to a legitimate public policy. The tribunal in *Impregilo v Argentina*, whose eminent members disagreed on several key issues, agreed on the following:

the term "fair and equitable treatment", as it appears in the present BIT and in other similar BITs, is intended to give adequate protection to the investor's legitimate expectations. [...] [T]he legitimate expectations of the investors [...] have to be evaluated considering all circumstances. In the Tribunal's understanding, fair and equitable treatment cannot be designed to ensure the immutability of the legal order, the economic world and the social universe and play the role assumed by stabilization clauses specifically granted to foreign investors with whom the State has signed investment agreements. [...] The legitimate expectations of foreign investors cannot be that the State will never modify the legal framework, especially in times of crisis, but certainly investors must be protected from unreasonable modifications of that legal framework.⁵³

The key legal issue identified by the *Impregilo* tribunal is not whether the host State had

Shore, Weiniger *International Investment Arbitration – Substantive Principles* (Oxford, OUP 2017 second edition) at 309 et seq.

⁵¹ *EDF v Romania*, Award, 8 October 2009, para. 217. See also *Total v Argentina*, Decision on Liability, 27 December 2010, para. 117.

⁵² See also *Parkerings v Lithuania*, para. 332 ("Save for the existence of an agreement, in the form of a stabilization clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment.") and *Paushok v Mongolia*, Award on Jurisdiction and Liability, 28 April 2011, para. 305.

⁵³ *Impregilo v Argentina*, Award, 21 June 2011, paras 285, 290-91.

introduced a (substantial) change in the general regulatory framework to the detriment of the foreign investment, but rather whether that change was indeed *reasonable* in light of the various circumstances and interests at issue.⁵⁴

Third, some tribunals have subjected the protection of the investor's legitimate expectations to a balancing act that takes in to account, next to investors' legitimate or reasonable expectations, the host State's right to regulate. For example, the tribunal in *Perenco v. Ecuador* noted the following:

Many cases hold that a central aspect of the analysis of an alleged breach of the fair and equitable treatment standard is the investor's reasonable expectations as to the future treatment of its investment by the host State. [...] The search is for a balanced approach between the investor's reasonable expectations and the exercise of the host State's regulatory and other powers.⁵⁵

Based on these various pronouncements, it can be argued that, despite those few early decisions that appeared to easily embrace a strict stability obligation, subsequent arbitral practice has shown more deference vis-à-vis the host State's right to regulate and supported a softer understanding of FET as a guarantee of regulatory stability. In particular, arbitral tribunals' focus on (a) the existence of a stabilisation commitment or promise, (b) the reasonableness of the host State measure and/or (c) the need to balance investor's expectations and the host State's right to regulate represent strong evidence that many subsequent investment tribunals have not endorsed a reading of the FET provision (and the related doctrine of legitimate expectations) that would include an obligation of regulatory stability in the strict sense.

V. FET, regulatory change and recent arbitral practice: persistent ambiguity

⁵⁴ *Parkerings v Lithuania*, para. 332 ("What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power."); *Micula v Romania*, Final Award, 11 December 2013, para. 529 ("In the Tribunal's view, the correct position is that the state may always change its legislation, being aware and thus taking into consideration that: (i) an investor's legitimate expectations must be protected; (ii) the state's conduct must be substantively proper (e.g., not arbitrary or discriminatory); and (iii) the state's conduct must be procedurally proper (e.g., in compliance with due process and fair administration)."); *Charanne v Spain*, Award, 21 January 2016, paras. 510 and 513 ("an investor has a legitimate expectation that, when modifying the existing regulation based on which the investment was made, the State will not act unreasonably, disproportionately or contrary to the public interest."). See Maynard, above, at 113-114 for the suggestion to apply a reasonableness test to the legal stability obligation.

⁵⁵ *Perenco Ecuador Ltd. v. The Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador)*, Decision on Remaining Issues of Jurisdiction and Liability, 12 September 2014, para. 560. See *Lemire v Ukraine*, Decision on Jurisdiction and Liability, 10 January 2010, paras 284-85; *El Paso v Argentina*, Award, 31 October 2011, para. 358 ("a balance should be established between the legitimate expectation of the foreign investor to make a fair return on its investment and the right of the host State to regulate its economy in the public interest."). See further Jonathan Bonnitcha, *Substantive Protection under Investment Treaties* (Cambridge, CUP 2014) at 175-90.

This section aims to determine whether the softer reading of the regulatory stability obligation described in the previous section has been consolidated in the most recent arbitral practice. This examination reveals how some investment tribunals still fail to clearly set out the role of regulatory stability within the FET standard. In particular, (a) they fail to take a clear position on whether or not FET includes a requirement of regulatory stability in the strict sense and (b) they fail to clarify the kind of regulatory change that would entail a breach of the FET provision.

- (a) While investors continue to argue that FET includes a requirement of regulatory stability in the strict sense, some tribunals fail to take a clear position on whether or not FET includes such a requirement

In their claims brought against host States, investors still regularly argue for a broad reading of the FET provision that includes an obligation of regulatory stability in the strict sense. In *Philip Morris v Uruguay*, a case involving various legislative measures aimed at restricting the use of brands on cigarette packages, claimants argued that investors' expectations may rise inter alia from "general statements, the legal framework, legislation" and that "specific, explicit promises to an investor [...] are not necessary".⁵⁶ Furthermore, in *Philip Morris v Uruguay*, while they accepted that "it is a State's prerogative to exercise its regulatory and legislative powers", the claimants argued that those powers "must not be 'outside of the acceptable margin of change'".⁵⁷ To support their claims, investors usually refer to any of the early decisions that, as examined above, contained language that appeared to support a broad reading of the FET provision.⁵⁸

While it is unsurprising that claimants argue for a broad reading of FET and base their arguments on the most supportive precedents, it is nonetheless disappointing that some arbitral tribunals do not take a clearer stance (one way or the other) with regard to the extent to which the FET provision disciplines adverse regulatory change. The tribunals' decisions in *Philip Morris v Uruguay* and *Antaris v The Czech Republic* are good examples of this.

As noted above, the *Philip Morris v Uruguay* tribunal was confronted with the investor's claim that various legislative measures introduced by Uruguay restricting the use of brands on cigarette packages violated the FET provision in the Switzerland-Uruguay BIT principally because (a) the measures were arbitrary, (b) they frustrated the investor's legitimate expectations and (c) they failed to provide a stable and predictable legal system. Having decided to consider the latter two grounds "in the same context due to their interrelation",⁵⁹ the *Philip Morris v Uruguay* tribunal stated as follows:

⁵⁶ *Philip Morris v Uruguay*, Award, 8 July 2016, para. 342.

⁵⁷ *Philip Morris v Uruguay*, Award, 8 July 2016, para. 346 referring to *El Paso v Argentina*, Award.

⁵⁸ Claimants in *Philip Morris v Uruguay* refer to *Tecmed* and *Occidental v Ecuador I*, see Award, 8 July 2016, paras 340 and 346; claimants in *Antaris & Gode v The Czech Republic* refer to *Tecmed*, *CMS*, *Occidental I*, and *Enron* (see Award, 2 May 2018, para. 266).

⁵⁹ *Philip Morris v Uruguay*, Award, 8 July 2016, para. 421.

422. It is common ground in the decisions of more recent investment tribunals that the requirements of legitimate expectations and legal stability as manifestations of the FET standard do not affect the State's rights to exercise its sovereign authority to legislate and to adapt its legal system to changing circumstances.

423. On this basis, changes to general legislation (at least in the absence of a stabilization clause) are not prevented by the fair and equitable treatment standard if they do not exceed the exercise of the host State's normal regulatory power in the pursuance of a public interest and do not modify the regulatory framework relied upon by the investor at the time of its investment "outside of the acceptable margin of change."⁶⁰

While these statements do reflect the greater sensitivity shown by investment tribunals vis-à-vis the host State's right to regulate, one can still find language there that may be perceived as supporting a rather strict stability obligation. Particularly, both the tribunal's express reference to a 'requirement of legal stability' (which is in addition to the requirement of legitimate expectations and non-arbitrariness) and its express recognition that a modification of the regulatory framework 'outside of the acceptable margin of change' is indeed prohibited by the FET provision fail to completely clarify whether or not FET includes an obligation of regulatory stability in the strict sense. Without any elaboration of what is exactly the 'acceptable' margin of change, it remains unclear what kind of regulatory change would entail a breach of the FET provision, particularly as one could read the latter ground ('modification of the regulatory framework outside of an acceptable margin') as *alternative* to (and thus different from) the former one ('exceeding the exercise of the host State's normal regulatory powers').

This uncertainty is carried over to the tribunal's ultimate findings rejecting Philip Morris' FET claim. The (majority of the) tribunal distinguished between the legitimate expectation claim and the legal stability claim, and appeared to base its rejection of the latter claim on the finding that the *effect* of the measures under review had *not* been to modify the stability of the host State's legal framework.⁶¹ Thus, one can still advance the argument that the majority of the tribunal accepted, at least in principle, a reading of the FET provision as a guarantee of regulatory stability in the strict sense.⁶²

In the second example, the tribunal in *Antaris v The Czech Republic* was confronted with the claim that the host State's modification of its incentive regime in the photovoltaic sector had violated the FET provision in the Energy Charter Treaty and the Germany-Czech Republic BIT because the policy change violated the obligation (a) to provide a stable and predictable legal framework, (b) to protect an investor's legitimate expectations and (c) not to impair the

⁶⁰ *Philip Morris v Uruguay*, Award, 8 July 2016, paras. 422-23.

⁶¹ *Philip Morris v Uruguay*, Award, 8 July 2016, paras. 433-34.

⁶² Another recent example of such (possible) implicit recognition may be found in *Eli Lilly and Company v Canada*, Final Award, 16 March 2017, paras 386-389.

investment through arbitrary and unreasonable behaviour.⁶³

The *Antaris* tribunal's analysis begins with the recognition of the existence of a vast arbitral practice (which the disputing parties had referred to) interpreting and applying the FET standard. The tribunal then puts forward thirteen "general propositions" stemming from such practice, which include the following:

- (1) There will be a breach of the FET standard where legal and business stability or the legal framework has been altered in such a way as to frustrate legitimate and reasonable expectations or guarantees of stability. [...]
- (3) A claimant must establish that (a) clear and explicit (or implicit) representations were made by or attributable to the state in order to induce the investment [...].
- (6) Provisions of general legislation applicable to a plurality of persons or a category of persons, do not create legitimate expectations that there will be no change in the law [...].
- (7) An expectation may be engendered by changes to general legislation, but, at least in the absence of a stabilization clause, they are not prevented by the fair and equitable treatment standard if they do not exceed the exercise of the host State's normal regulatory power in the pursuance of a public interest and do not modify the regulatory framework relied upon by the investor at the time of its investment outside the acceptable margin of change.
- (8) The requirements of legitimate expectations and legal stability as manifestations of the FET standard do not affect the State's rights to exercise its sovereign authority to legislate and to adapt its legal system to changing circumstances. [...]

While the *Antaris* tribunal does acknowledge that several of these propositions "overlap with each other" and that its decision to ultimately reject the investors' FET claims "is not based on all of those propositions", the tribunal fails to recognise the (at least potential) inconsistency of several of those propositions and thus to take a clear position on whether, and the extent to which, FET includes an obligation of regulatory stability in the strict sense.⁶⁴

- (b) While claimants always seem to argue that the regulatory change under review is substantial or drastic, some investment tribunals fail to clarify the kind of change that *per se* qualifies for a breach of the FET provision

A second controversial issue revolves around the kind of regulatory *change* that is required in

⁶³ *Antaris v Czech Republic*, Award, paras 262-264.

⁶⁴ The dissenting arbitrator seems to highlight the inconsistency of the tribunal's decision. *Antaris v Czech Republic*, Dissenting Opinion, 2 May 2018. Furthermore, the two decisions in *Philip Morris* and *Antaris* are also examples of the failure by arbitral tribunals to elaborate the relationship, if any, between the investor's claim based on the obligation to provide a stable legal framework and the claim based on the obligation to protect its legitimate expectations (*Philip Morris v Uruguay*, Award, at para. 421 and *Antaris*, Award, at para. 363).

order to determine a violation of the FET provision. At the beginning of the paper, I posited the conceptual distinction between a strict and soft stability obligation, where the former focuses on the existence of a regulatory change and the latter entails (at least in part) an analysis of the merit (ie., fairness or reasonableness) of the measure under review (ie., the change in regulation).

In their FET claims, investors often highlight the magnitude of the regulatory change put in place by the host State (a) by arguing that the host State has “profoundly altered the stability and predictability of the investment environment”,⁶⁵ (b) by referring to the legal framework as “exceptionally unstable”,⁶⁶ or (c) by describing the regulatory change as ‘radical’.⁶⁷ Similarly, the claimants in *Blusun v Italy*, another recent dispute involving the photovoltaic sector, emphasised the relentlessness of the regulatory changes by describing their claim as follows:

Our claim is not that Italy’s legislation had to remain immutable, unchanged, written in stone. This case is not about regulatory change; it’s about regulatory turbulence. It concerns the fact that during the two years between permissible and legally impossible, the legal framework for the project constantly changed, leaving no period of stability in which the requisite capital investment for a project of this size could be realised.⁶⁸

Notwithstanding the various qualifiers (‘profound’, ‘exceptional’, ‘radical’, ‘constant’) used by foreign investors to describe the adverse regulatory changes introduced by the host State, these claimants appear to rely on a *strict* notion of regulatory stability, albeit possibly a more limited one, as only ‘substantial’ changes will constitute a breach of the FET.

Confronted with such claims, the investment tribunal’s key task is to clarify the notion of regulatory stability that applies for purposes of determining a violation of the FET provision. In other words, in the absence of a stabilization commitment, does the adverse regulatory change violate the FET provision because it is a *radical* or *substantial* change or because it is

⁶⁵ *CMS v Argentina*, Award, 12 May 2005, para. 267. See also *El Paso v Argentina*, Award, 2011, para. 351, where the tribunal refers to the following quote by the investor: “Claimant does not call into question Argentina’s right to change its laws or regulations. It has never been Claimant’s position that the BIT imposes an absolute obligation not to alter the regulatory framework. [...] But the complete alteration of the regulatory framework in a manner that does not reasonably protect existing capital investments promoted by the government necessarily frustrates the legitimate expectations of investors.”

⁶⁶ *Mamidoil v Albania*, Award, 30 March 2015, para. 590.

⁶⁷ *Eli Lilly and Company v Canada*, Final Award, 16 March 2017, para. 227 (“Claimant argues that the promise utility doctrine is a radical departure from Canada’s traditional utility standard [...]”). See also *El Paso v Argentina*, Award, 2011, para. 390 (“in [the claimant’s] view, the decisions and regulations in issue [...] that brought a radical alteration of key rules, effectively eviscerated the existing regulatory frameworks, and therefore exceeded normal regulatory powers.”). See also *Eiser v Spain*, Award, 4 May 2017, para. 358 (“The drastic changes adopted by Respondent defeated Claimants’ legitimate expectations of stability [...]”).

⁶⁸ *Blusun v Italy*, Award, 27 December 2016, para. 320.

an *unreasonable* or *disproportionate* change? Unfortunately, an examination of a few recent awards shows that some tribunals still fail to clarify the kind of regulatory change that would qualify for a breach of the FET provision.

For example, as noted above, while it ultimately rejected the investor's claim, the *Philip Morris v Uruguay* tribunal seems to accept in principle that changes to the regulatory framework are in violation of the FET provision if they are "outside of the acceptable margin of change".⁶⁹ The tribunal however does not clarify what it means by 'acceptable' margin of change: does the regulatory change become 'unacceptable' because it is 'substantial' (or even 'total') or is it unacceptable because the change is 'unreasonable' (or disproportionate)? The *Philip Morris v Uruguay* tribunal's succinct reasoning for rejecting the investor's FET claim regarding the 'stability of the legal framework' only adds to the uncertainty as the tribunal focuses on the fact that the measures under review had "limited impact" on the investor's business and the effect of the measures under review "had not been such as to modify the stability of the Uruguayan legal framework."⁷⁰

Similarly, the tribunal in *Eli Lilly v Canada* was confronted with a claim that the Canadian court's interpretation of the utility requirement under Canadian patent law, and in particular their adoption of the promise utility doctrine in the mid-2000s, allegedly departing dramatically from prior Canadian patent law, violated, inter alia, the FET standard in Article 1105 NAFTA. While the *Eli Lilly* tribunal ultimately rejected the investor's claim as the investor failed to demonstrate a "fundamental or dramatic change" in Canadian patent law, it remains unclear what the tribunal meant for a 'dramatic' change. Looking at the various factors examined by the tribunal (including the utility requirement in Canadian jurisprudence, relevant Canadian regulatory practice and statistical evidence), one can argue that the *Eli Lilly* tribunal was indeed focusing on whether there had been a substantial change in law, rather than whether the change in law was arbitrary or disproportionate.⁷¹ However, some of the tribunal's conclusions (stressing the 'incremental and evolutionary' nature of the change

⁶⁹ *Philip Morris v Uruguay*, Award, 8 July 2016, para. 423. It should be noted that the phrase 'outside of the acceptable margin of change' comes from the *El Paso v Argentina* tribunal, in the context of a long and (perhaps over-) elaborated decision, which contains some apparently conflicting statements: compare "the legitimate expectations of a foreign investor can only be examined by having due regard to the general proposition that the State should not unreasonably modify the legal framework or modify it in contradiction with a specific commitment not to do so" (para. 364) with "[t]here can be no legitimate expectation for anyone that the legal framework will remain unchanged in the face of an extremely severe economic crisis. No reasonable investor can have such an expectation unless very specific commitments have been made towards it or unless the alteration of the legal framework is total" (para. 374) [emphasis added].

⁷⁰ *Philip Morris v Uruguay*, Award, paras. 433-34.

⁷¹ See Robert Howse "*Eli Lilly v Canada*: A Pyrrhic Victory Against Big Pharma" International Economic Law and Policy Blog, 26 March 2017, ("On those exceptional but usually very important occasions when high courts reconsider well-established judicial doctrines in the face of social, economic, environmental or other forms of rapid change we experience in the world today, they must now beware that any basic or fundamental reorientation of their jurisprudence could force that state's government to pay out millions or even billions to foreign corporations in the guise of an "expropriation" having occurred [or a breach of the FET provision].")

and suggesting some of the reasons that may have led to such change) seem to imply instead a focus on the reasons for (or the reasonableness of) the change.⁷²

A third example of a tribunal's failure to clarify the kind of regulatory change required to establish a violation of the FET provision is the decision in *Eiser v Spain*. In that arbitration, the tribunal was confronted with the claim, brought exclusively under the ECT, that the host State had violated the FET provision because of the drastic changes it had introduced in the subsidies provided to solar energy producers. In line with the more deferential approach shown by most tribunals since *Saluka*, the *Eiser* tribunal recognised that "absent explicit undertakings [...] investment treaties do not eliminate States' right to modify their regulatory regimes to meet evolving circumstances and public needs" and that "the FET standard does not give a right to regulatory stability *per se*."⁷³ The tribunal, however, added two further statements that appear to qualify, in important ways, the previous one. The tribunal first stated that the FET provision "does protect from a fundamental change to the regulatory regime in a manner that does not take account of the circumstances of existing investments made in reliance on the prior regime."⁷⁴ Second, the tribunal added that, while the ECT did not bar Spain from making appropriate changes, "the ECT did protect Claimants against the total and unreasonable change that they experienced here."⁷⁵

The key question put forward above presents itself, once again. Is the *Eiser* tribunal relying on a strict notion of regulatory stability (albeit more limited as only 'fundamental' or 'total' changes will constitute a breach of the FET) or is the tribunal instead relying on a soft notion of regulatory stability where those qualifiers merely represent the evidence of an unreasonable or disproportionate behaviour by the host State? The language used by the tribunal is not helpful in fully understanding what is the kind of change required and thus the nature of the obligation imposed on the host State through the FET provision. The ambiguity is also reinforced by the fact that, in its ultimate finding of violation of the FET provision, the *Eiser* tribunal refers to the new regulatory approach both as "unprecedented and wholly different" and as "profoundly unfair and inequitable [...] stripping Claimants of virtually all of the value of their investment."⁷⁶ While one can argue that the tribunal's finding of violation was based both on *the extent of* the regulatory change at issue and *the disproportionate nature of* that change, it is not clear whether an unprecedented change would in principle be sufficient to breach the FET provision. It thus remains unclear whether

⁷² *Eli Lilly v Canada*, Award, 16 March 2017, para. 386 ("Taken as a whole, the evidence before the Tribunal shows that Canada's utility requirement underwent incremental and evolutionary changes [...]. Over those years, there was an increase in the number of utility-based challenges of pharmaceutical patents, which appears to have increased the pace of the development of the law most relevant to that sector."). On the other hand, the fact that the tribunal proceeded next to examine whether the utility requirement under Canadian law is 'arbitrary' may undermine this second reading of what constitutes a 'dramatic' change.

⁷³ *Eiser Infrastructure Limited and Energia Solar Luxembourg SARL v Spain*, Award, 4 May 2017, para. 362.

⁷⁴ *Eiser*, para. 363.

⁷⁵ *Eiser*, para. 363.

⁷⁶ *Eiser*, para. 365.

the tribunal relied on a strict or soft notion of regulatory stability obligation.

VI. Conclusion

Compared to some of the statements found in the decisions of ‘early’ tribunals, there is no doubt that most arbitral practice of the last ten years has expressly recognized the host State’s right to regulate in the public interest including the right to modify its laws and regulations. The paper has nonetheless shown that investment tribunals have retained, as part of the FET standard, both the obligation to provide a stable legal framework and the obligation to protect the investor’s legitimate expectations. Moreover, the paper has advanced the argument that several investment tribunals remain ambiguous with regard to the extent to which the FET standard disciplines regulatory change in the absence of a stabilization commitment. In particular, it is not clear whether tribunals interpret the FET provision as imposing a strict stability obligation that focuses on the existence of an adverse regulatory change or a soft stability obligation that focuses instead on the regulatory change’s fairness, reasonableness or proportionality.

The decisions in *Philip Morris v Uruguay*, *Ely Lilly v Canada*, *Eiser v Spain*, *Blusun v Italy*, and *Antaris v Czech Republic*, analysed above, are all examples of such ambiguity. In none of these decisions, it is clear whether the tribunal viewed the FET provision as protecting foreign investors from ‘adverse regulatory change’ or from ‘unreasonable or disproportionate’ new regulation. This ambiguity remains even when the tribunal highlights the ‘seriousness’ or ‘radicality’ of the regulatory change under review (as in *Ely Lilly* and *Eiser*), as it is not clear whether or not the ‘seriousness’ or ‘radicality’ assessment implies an examination of the (lack of) ‘reasonableness’ or ‘proportionality’ of the new regulation under review.

The underlying issue that the paper seeks to highlight is the apparent disregard shown by several investment tribunals of the fundamental difference between a strict stability guarantee and a soft stability guarantee. While the former is premised on the existence of a (serious or drastic) regulatory change, the latter is premised on the procedural fairness and substantive reasonableness of the new regulation introduced by the host State. In the absence of an express provision in the applicable investment treaty, a reading of the obligation to provide ‘fair and equitable treatment’ that does not clearly exclude the existence of a strict stability guarantee will continue to raise serious concerns from many quarters with regard to the excessive restraints imposed by investment treaties on the host State’s right to regulate. In this sense, several investment tribunals (and not just those from the ‘early’ days of investment treaty arbitration) are to be blamed for failing to clarify the content and scope of the FET standard in addressing adverse regulatory change and to assuage the fears that the FET standard may indeed function as imposing an obligation of regulatory stability in the strict sense.

It is difficult to identify in definitive terms the underlying causes of this persistent failure.

Does it stem from the open-ended nature of the key investment treaty standards (such as FET) and the decentralized nature of international investment adjudication? Does it stem from the existence of a still unresolved conflict between those supporting a reading of investment treaties as instruments providing foreign investors with a broad set of guarantees (including strict regulatory stability) and those that see those treaties as affording a narrower set of protections to foreign investment (not going beyond a prohibition of arbitrary, unreasonable or disproportionate conduct)? Or is it the very insistence by tribunals to employ the vague concept of a 'stability obligation'?

Underlying causes aside, one consequence of this state of affairs should be highlighted here. The persistent lack of clarity with regard to FET and regulatory stability may definitely lead policy makers to realize that this failure cannot be resolved, at least at the appropriate pace, through the evolving nature of arbitral practice and that instead it is up to them to solve it.